

**Commissioner of Income-tax, Central Vs. Bird and Co. (P.) Ltd.**

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**Court :** Kolkata

**Decided On :** Jul-28-1975

**Reported in :** [1977]108ITR253(Cal)

**Judge :** S.C. Deb and ;Dipak Kumar Sen, JJ.

**Acts :** [Income Tax Act, 1922](#) - Section 23A and 23A(1); ;[Companies Act, 1956](#); ;Companies (Amendment) Act

**Appeal No. :** Income-tax Reference No. 377 of 1969

**Appellant :** Commissioner of Income-tax, Central;bird and Co. (P.) Ltd.

**Respondent :** Bird and Co. (P.) Ltd.;commissioner of Income-tax, Central

**Advocate for Pet/Ap. :** B.L. Pal, ;Ajit Sengupta, ;Kalyan Roy and ;R.N. Datta, Advs.

**Judgement :**

Dipak Kumar Sen, J.

1. In this reference under Section 66(1) of the Indian Income-tax Act, 1922, the following questions have been referred :

Assessment year 1955-56

'1. Whether, on the facts and in the circumstances of the case, the goodwill of the assessee-company constituted a 'fixed asset' within the meaning of proviso (b) to Section 23A(1) of the Indian Income-tax Act, 1922, as the section stood at the relevant time ?

2. Whether, on the facts and in the circumstances of the case, the amounts written off from goodwill account by debiting capital reserve account and profit and loss account constituted 'reserves representing accumulations of past profits' within the meaning of proviso (b) to Section 23A(1) of the Indian Income-tax Act, 1922 '

Assessment years 1958-59, 1959-60 and 1960-61

'1. Whether, on the facts and in the circumstances of the case, the goodwill of the assessee-company constituted a 'fixed asset' within the meaning of Explanation 2(iv) (a) to Section 23A of the Indian Income-tax Act, 1922?

2. Whether, on the facts and in the circumstances of the case, the amounts written off from goodwill account by debiting capital reserveaccount and profit and loss account

constituted 'accumulated profits and reserves ' within the meaning of Explanation 2(iv)(a) of Section 23A of the Indian Income-tax Act, 1922 ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that in determining the commercial profits the write off of goodwill made in each of the relevant accounting periods was not a legitimate business expenditure ?

4. If the answer to question No. 3 is in the affirmative, whether the Tribunal was right in holding that having regard to the commercial profits a larger dividend than that declared by the company could reasonably have been distributed ?'

2. The facts found as appearing in the statement of the case and the annexures thereto can be shortly stated as follows ;

The relevant assessment years are 1955-56, 1958-59, 1959-60 and 1960-61, the corresponding previous years being the preceding calendar years. Bird & Co. (Private) Ltd., the assessee, is a private limited company and had been the managing agents of several companies.

3. In each of the assessment years in question the assessee had declared dividends. Such dividend was not less than sixty per cent. of its distributable surplus for the assessment years 1955-56, 1958-59 and 1959-60 and not less than sixty-five per cent. thereof for the assessment year 1960-61 as normally required under Section 23A of the Indian Income-tax Act, 1922. But such declared dividend fell short of the enhanced statutory percentage also laid down by the said Section 23A. Under the said section the enhanced statutory percentage being 100% for the assessment year 1955-56 and 95% for the other assessment years was applicable where the accumulated profits and reserves (including the amounts capitalised from the earlier reserves) representing accumulation of past profits which had not been the subject of an order under Section 23A(1) exceeded either the aggregate of the paid up capital and loan capital or the actual cost of the fixed assets, whichever was the greater.

4. On the computation of the assessee in each of the assessment years in question the aggregate of its reserves and accumulated profits did not exceed the cost of its fixed assets and hence the assessee claimed exemption for higher statutory percentage.

5. For such computation the assessee treated its goodwill to be a fixed asset and the value of such goodwill was taken at the original cost.

6. In proceedings under Section 23A the Income-tax Officer held that goodwill of the assessee was an intangible asset and could not be considered to be a fixed asset. Even otherwise he held the cost of the goodwill could not be taken at its original value ignoring the amounts written off from time to time. By such write-off the reserve and accumulated profits were found to have been depleted and thereby secret reserves were created. On such basis the Income-tax Officer held that the cost of the fixed assets of the assessee was not more than the aggregate of the reserves and accumulated profits and, further, such reserves and accumulated profits exceeded the paid up capital excluding bonus capital created out of profits and gains not subjected to the provisions of Section 23A. He held that the assessee was liable to distribute dividend at the enhanced statutory percentage and levied additional surtax in each of the assessment years.

7. The assessee appealed to the Appellate Assistant Commissioner. In disposing of the appeals the Appellate Assistant Commissioner held that goodwill was a fixed asset. He further held that to the extent the goodwill of the assessee was reduced by debiting the profit and loss account, the same could not be held to be nor did the same constitute a reserve. But he found that in the assessment year 1954-55 when the goodwill was written off to the extent of Rs. 30,00,000 a corresponding reduction was made in the capital reserve account on the liabilities side of the balance-sheet. He held that as the said amount had been treated as a reserve all along and in the assessment year in question though the same was deducted from the goodwill it still constituted reserve within the meaning of Section 23A.

8. He held, however, that the other amount of Rs. 22,00,000 debited in the profit and loss account of the assessee at the rate of Rs. 3 lakhs each year really came out of accumulated profits which was available for debiting against the goodwill. In the premises, he held that this amount should also be treated as accumulated profits for the purposes of the said Section 23A.

9. On such basis, he held that the accumulated profits and reserve including the amounts capitalised from the earlier reserves representing accumulations of past profits exceeded the actual cost of fixed assets in all the assessment years and the enhanced statutory percentage of 90% and 100% were applicable for the purpose of distribution of dividend. The orders of the Income-tax Officer passed under Section 23A were confirmed.

10. Being aggrieved by this appellate order the assessee went up on further appeal before the Tribunal. It was contended before the Tribunal on behalf of the assessee that there was sufficient evidence to indicate that the market value of the goodwill became lower than the balance-sheet value and that such evidence had been duly placed before the Appellate Assistant Commissioner. The Companies (Amendment) Bill was introduced on the 2nd September, 1953, when there was a recommendation that all managing agencies should cease by the 15th August, 1959. In view of the said Bill the directors of the assessee prudently scaled down the book value of the goodwill by Rs. 30 lakhs in that very year. The sole motive for the reduction in the value of the goodwill was the Companies (Amendment) Act, and there was no tax evasion nor even any tax avoidance angle to it. The subsequent annual reductions in value of the goodwill were also similarly motivated.

11. It was further contended that the report of the valuers in the wealth-tax assessment of the assessee has also been tendered as evidence. For the assessment year 1957-58, the original two valuers had submitted different reports whereupon the matter was referred to a third valuer and the latter fixed the value of such goodwill for that particular year at Rs. 7 lakhs. For the next assessment year 1958-59, the unanimous valuation of such goodwill was Rs. 6 lakhs. It was submitted that in none of the years under appeal had the book value of the assessee's goodwill had fallen below that figure.

12. The Tribunal held that the reduction in the book value of the goodwill was not without justification, and was, therefore, not open to challenge on that ground at least upon and including the assessment year 1960-61, the last of the five assessment years in issue.

13. Following the principles laid down by the Bombay High Court in Bombay Cycle &

Motor Agency Ltd. v. Commissioner of Income-tax : [1964]54ITR358(Bom) , the Tribunal further held that, as the reduction in the value of the goodwill was not without justification, the amounts written off from the goodwill account did not form part of the accumulated profits and reserves of the assessee in the respective assessment years.

14. A new ground of appeal, viz., that having regard to the financial position, the declaration of a larger dividend would have been unreasonable, was also urged on behalf of the assessee before the Tribunal. The Tribunal found that, except for the assessment year 1955-56, the dividends exceeded the available surplus (as computed by the assessee) in all the years. The Tribunal, however, found that the commercial profit had been worked out by the assessee after charging a sum of Rs. 5 lakhs towards the writing off of the goodwill in each of the years. The Tribunal held that this was not a legitimate business expenditure. According to the Tribunal the commercial profit had to be enhanced by Rs. 5 lakhs in each of the assessment year in question and, in that view, there was no paucity of profits in the said assessment years except the year 1957-58. For the said assessment year 1957-58, the contentions of the department were that the capital loss for that year had not been proved and, secondly, the same being a capital loss should not be taken into account for the purpose of declaration of dividend. The Tribunal rejected the above contentions of the department and accepted the accounts of the assessee which were found to have been duly audited and passed. Following the decision of the Supreme Court in the case of Gangadhar Banerjee : [1965]57ITR176(SC) , the Tribunal held that capital gains or losses had to be taken into account in deciding the reasonableness of the dividend declared. The Tribunal held that the declaration of a larger dividend for the said assessment year 1957-58 would have been unreasonable and allowed the appeal for that year only.

15. The department, in the appeal to the Tribunal, had also challenged the decision of the Appellate Assistant Commissioner that the goodwill of the assessee was a fixed asset. The Tribunal followed one of its earlier decisions and upheld the order of the Appellate Assistant Commissioner on this point. A decision of this court in the case of Commissioner of Income-tax v. Chunilal Prabhudas & Co. : [1970]76ITR566(Cal) was cited before the Tribunal in support of the contentions of the department. The Tribunal found that the law laid down in that case did not apply to the facts and circumstances of the case before it.

16. In the present reference before us, Mr. B.L. Pal, learned counsel for the revenue, contended in respect of question No. 1 (for the assessment year 1955-56, as also the assessment years 1958-59, 1959-60 and 1960-61), that in view of the decision of this court in the case of Commissioner of Income-tax v. Chunilal Prabhudas & Co. : [1970]76ITR566(Cal) referred to earlier, goodwill should not be held to be even a capital asset and, therefore, no question arose whether it was a fixed asset or not. He relied on the following passage from the judgment of P.B. Mukharji J., as he then was (page 571).

'But the question then finally boils down to this : whether goodwill is a 'capital asset' within the meaning of Section 12B of the Indian Income-tax Act, 1922, read with Section 2(4A) of the Act. In order to be taxable capital gain within the meaning of Section 12B of the Income-tax Act, there has to be four primary tests, namely, (1) profit or gain, (2) capital asset, (3) arising out of and (4) sale, exchange and relinquishment or transfer.

It is difficult to apply these tests to the case of goodwill. Goodwill fails in the test of capital asset. To begin with, goodwill is not any kind of usual capital asset with which a business is started. It is not a capital asset which can be divided into parts, fragments or fractions or entered on the stock book or register of capital assets nor can it, like capital asset, exist independently without the business itself and have any value apart from business usually associated with capital asset. Unlike capital assets goodwill as an asset is indivisible and cannot be sold, transferred or dealt with in fragments or fractions. On the interpretation of Section 2(4A), Section 2(4C) and Section 12B and on their express words and tenor, goodwill does not come within the obvious meaning of capital asset. To bring goodwill within the meaning of capital asset and make it taxable would be to tax by implication or by analogy or by a forced and artificial construction.'

17. This Bench had occasion to consider the above decision of this court in I.T.R. Reference No. 5 of 1972 (K.N. Daftary v. Commissioner of Income-tax : [1977]106ITR998(Cal) ). In Chunilal's case : [1970]76ITR566(Cal) goodwill was considered in the context of Section 12B of the Indian Income-tax Act, 1922, and it was held that goodwill did not fall and was not intended to be brought within the ambit of the said section. It does not appear to us that it was laid down in Chunilal's case : [1970]76ITR566(Cal) that goodwill should not be held to be a capital asset in the context of other sections of the Income-tax Act.

18. In the case of R. C. Cooper v. Union of India : [1970]3SCR530 the Supreme Court observed as follows:

'Goodwill of a business is an intangible asset : it is the whole advantage of the reputation and connections formed with the customers together with the circumstances making the connection durable.'

19. In the case of Devidas Vithaldas & Co. v. Commissioner of Income-tax : [1972]84ITR277(SC) the Supreme Court again observed as follows :

'Acquisition of the goodwill of the business is, without doubt acquisition of a capital asset, and, therefore, its purchase price would be capital expenditure. It would not make any difference whether it is paid in a lump sum at one time or in instalments distributed over a definite period.' Mr. Kalyan Roy, learned counsel on behalf of the assessee, cited a passage from the well-known treatise, Buckley on the Companies Acts, 13th edition, at page 967, as follows : 'The Act (Companies Act, 1948, Schedule VIII) contains no definition of 'fixed assets' or 'current assets', but these terms must be intended to cover every kind of asset and to be mutually exclusive, so that every kind of asset which is not 'fixed' is 'current' and vice versa. An indication of the nature of ' fixed assets ' may be gained from para. 5 and of 'current assets' from para. 11(7). Semble, any asset, such as stock-in-trade, cash, expendable stores and book debts, liable to be realised, expended or turned over in the ordinary course of the company's business is a 'current asset', whereas assets of a capital nature, such as the company's premises, plant machinery, investments and goodwill, are ' fixed assets ' . '

20. In Halsbury's Laws of England, third edition, volume 6, at page 397, the law as prevailing in England is stated as follows :

'Fixed capital.--Part of the capital of a company may consist of fixed capital and part

of circulating capital. By fixed capital is meant that capital which a company retains in the shape of assets upon which the subscribed capital has been expended and which assets either themselves produce income independently of any further action by the company, or, being retained by the company, are made use of to produce income or gain profits...Goodwill is also part of the fixed capital.'

21. Coming to the [Companies Act, 1956](#), the statutory form of the balance-sheet set out in Part I of Schedule VI to the said Act has, under the heading 'assets' a sub-heading 'fixed assets'. It is stated that the items under this sub-heading should be distinguished as far as possible between expenditure upon, (a) 'goodwill', and (b) 'land', etc. From this it appears that so far as the law relating to companies in India is concerned, the statute also recognises goodwill to be a fixed asset.

22. In such view of the law as noted above we hold that the goodwill of the assessee in the instant case constituted a fixed asset within the meaning of Explanation 2(iv) (a) to Section 23A of the Indian Income-tax Act, 1922.

23. On question No. 2 which has been raised for all the assessment years, Mr. Pal could not cite any authority supporting the contentions of the revenue. Nor could he distinguish the decision of the Bombay High Court in the case of *Bombay Cycle & Motor Agency Ltd. v. Commissioner of Income-tax* : [1964]54ITR358(Bom) . In that case the Bombay High Court observed as follows :

'.....the company, if it wanted to bring back the goodwill as an asset on the balance-sheet of the company, would have been entitled to add the amount of profits applied in writing off the goodwill back to its accumulated profits or reserves, but it would be for the company to do so. If the company does not choose to do so and keeps the profits applied in writing off the goodwill as so applied, it will not be possible for anyone else to regard the said profits as still forming part of the accumulated profits or reserves, What the provision of Section 23A(1), proviso (b), has asked the income-tax authorities to determine is to find out the accumulated profits and reserves which exist as accumulated profits or reserves. What is adjusted out of the profits cannot be regarded as still forming part of either the accumulated profits or reserves.'

24. Nor could Mr. Pal distinguish the decision of this court in the case of *Commissioner of Income-tax v. Lothian Jute Mills Co. Ltd.* : [1967]66ITR630(Cal) . In this case the identical question arose in the calculation of accumulated profits and reserves of a company. G. K. Mitter J., as he then was, dealt with the question whether depreciation was really a reserve created out of profits. He held as follows (page 636):

'Under Section 211 of the Indian Companies Act, the balance-sheet of the company has to be prepared in the form prescribed in Schedule VI. The heads of reserve there shown are: '(1) capital reserves, (2) capital redemption reserve, (3) share premium account, (4) other reserves specifying the nature of each reserve and the amount in respect thereof, (5) surplus i.e., balance in profit and loss account after providing for proposed allocations, namely, dividend, bonus or reserves, (6) proposed additions to reserves, and (7) sinking funds'. Depreciation does not find a place there but in Part III, Clause 7(1)(b), the expression 'reserve' shall not, subject as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability. It would, therefore, appear that a provision for depreciation was not to be included in

any reserves. We find a similar provision in Schedule VIII, Part IV, of the English Companies Act of 1948. Clause 27(1)(b) gives the same interpretation of 'reserve' as is to be found in our Companies Act. Mr. Pal drew our attention to the case of Commissioner of Income-tax v. Bibhuti Bhusan Dutt [1963] 48 ITR 233 where a portion of the profits of a company was set apart for meeting depreciation of the fixed assets and this depreciation fund was added to year after year and was shown as a reserve in the balance-sheet. There it was held that it formed part of the accumulated profits for the purpose of Section 2(6A) of the Income-tax Act. It was said in that case that the assessee might not have created a reserve fund in respect of the depreciation but having done so, it was bound by its own act. If the company is not obliged to show depreciation in its balance-sheet by way of reserves and indeed ought not to do so under the form prescribed by Section 211, depreciation cannot be considered in the context of reserves.'

25. Mr. Pal next sought to argue within the ambit of the question that, in any event, the amount of rupees five lakhs which had been deducted every year from the profit and loss account on account of depreciation of goodwill was an ad hoc calculation and that it has not been found as a fact that the goodwill of the assessee was in fact depreciating at the rate per year.

26. It appears to us that it is no longer open to the revenue to raise this contention. From the order of the Tribunal in the instant case the revenue sought to raise an additional question as follows :

'Whether, on the facts and in the circumstances of the case, there was evidence before the Tribunal to show that the goodwill of the assessee-company was going down and that the assessee was justified in reducing the value of goodwill to the extent it did ?'

27. The Tribunal did not allow that question to be raised and held as follows :

'From the facts set out by us it is clear that the finding of the Tribunal that the value of goodwill of the assessee was declining from year to year and that the assessee was justified in reducing the value of the goodwill as appearing in the balance-sheet to the extent they did, was a decision arrived at solely with reference to the facts. No question of law arises therefrom and as such we decline to refer this question.'

28. It appears to us that it has been now found as a fact that the good will of the assessee depreciated at a rate as shown in the balance-sheet and that finding has not been challenged either as being perverse or being based on no evidence. As such, we cannot accept the contentions of Mr. Pal. We hold that the amounts written off from goodwill account by debiting the capital reserve account and the profit and loss account do not constitute accumulated profits and reserves as contended on behalf of the revenue.

29. Questions Nos. 3 and 4 were raised at the instance of the assessee. Mr. Ray, on behalf of the assessee, did not seriously press question No. 3 as the Tribunal itself had found as a fact that the goodwill had depreciated as the rates claimed by the assessee. The Tribunal had accepted the accounts of the assessee.

30. Mr. Ray submitted that if the said sum of rupees five lakhs debited each year from the profit and loss account could not be treated as a legitimate business expenditure,

still the same represented capital loss so far as the assessee was concerned and it had to be taken into account in determining whether the dividends distributed was reasonable or otherwise. Mr. Ray pointed out that the decision of the Supreme Court in the case of Commissioner of Income-tax v. Gangadhar Banerjee and Co. (P.) Ltd. : [1965]57ITR176(SC) was in fact cited before the Tribunal and the Tribunal duly noted the propositions laid down in the decision, including the proposition that capital gains or losses should be taken into account in deciding the reasonableness of the dividends declared.

31. Mr. Ray submitted that in any view of the matter the depreciation of the dividend for the said three assessment years had to be taken into account either as a business expenditure to be debited from the profit or loss account or as purely capital loss.

32. In the case of Commissioner of Income-tax v. Gangadhar Banerjee and Co. (P.) Ltd. : [1965]57ITR176(SC) the Supreme Court approved the law as laid down by the Judicial Committee in the case of Commissioner of Income-tax v. Williamson Diamonds Ltd. [1959] 35 ITR 290. In that case, the Judicial Committee had construed Section 21(1) of the Tanganyika Income-tax (Consolidation) Ordinance which is in pari materia with Section 23A of the Indian Income-tax Act, 1922. Their Lordships of the Judicial Committee observed as follows (page 297) :

'The form of the words used no doubt lends itself to the suggestion that regard should be paid only to the two matters mentioned, but it appears to their Lordships that it is impossible to arrive at a conclusion as to reasonableness by considering the two matters mentioned isolated from other relevant factors. Moreover, the statute does not say 'having regard only ' to losses previously incurred by the company and to the smallness of the profits made. No answer, which can be said to be in any measure adequate, can be given to the question of 'unreasonableness' by considering these two matters alone. Their Lordships are of the opinion that the statute by the words used, while making sure that 'losses and smallness of profits ' are never lost sight of, requires all matters relevant to the question of unreasonableness to be considered. Capital losses, if established, would be one of them.'

33. We find that there is substance in the contentions of Mr. Roy and we hold that the Tribunal erred in holding that a larger dividend than that which had been declared by the assessee could reasonably have been distributed having only in view the commercial profits and ignoring the capital loss incurred.

34. By reason of our findings as above, we answer the questions as follows:

Question No. 1 for the assessment year 1955-56 is answered in the affirmative and in favour of the assessee. Question No. 2 for the same assessment year is answered in the negative and also in favour of the assessee.

Questions Nos. 1 and 2 for the assessment years 1958-59, 1959-60 and 1960-61 are identical to the questions referred to above and are answered accordingly.

35. We decline to answer question No. 3 for the assessment years 1958-59, 1959-60 and 1960-61.

36. As we have declined to answer question No. 3, we reframe the question No. 4 for the said assessment years as follows.



'Whether the Tribunal was right in holding that having regard to the commercial profits a larger dividend than that declared by the company could reasonably have been distributed ?'

37. So far as reframed question No. 4 for these assessment years are concerned, we have already held that the Tribunal erred in considering only the commercial profits ignoring the capital loss incurred. To that extent this question is answered in the negative and in favour of the assessee.

38. We return our answers accordingly.

39. There will be no order as to costs.

Deb, J.

40. I agree.

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